



Michael C. Schlachter, CFA
Managing Director

November 13, 2007

Dr. Russell Read
Chief Investment Officer
California Public Employees' Retirement System
400 P Street, Suite 3492
Sacramento, CA 95814

Re: Inflation-Linked Asset Class - Item 4b

Dear Russell,

You requested Wilshire's opinion regarding Staff's proposal for some elements of the implementation of the new inflation-linked asset class pilot program. As directed by the Investment Committee in September, before additional assets may be funded Staff is required to develop 1) a statement of how the inflation-linked assets will be managed, 2) an expansion of the delegations matrix to include all elements of this new asset class, 3) detailed incentive compensation plans for all individuals concerned, and 4) policies for both the asset class and all underlying sub-asset classes. We recognize that this agenda item satisfies one of these criteria, as it lays out how the asset class will be initially managed and staffed. The agenda item does indicate, however, that as the asset class grows and matures, the staffing plan will evolve and personnel in other asset classes may eventually be migrated into this asset class, or new Staff may be retained. As a result, we agree that this is a good first step, and we look forward to working with Staff on the next iteration of this plan, as well as on the other elements required before additional investments can be made in this asset class. As outlined below, we also believe that this agenda item provides useful information regarding potential changes to incentive compensation, but does not yet satisfy that criteria for new investments.

We agree with Staff's proposal for a client-manager relationship for many of the assets in this program, at least initially. While Commodities is a stand-alone portfolio that can be easily migrated into the Inflation-Linked Asset Class, the TIPS portfolio team currently manages assets for the PERF fixed income portfolio and has the capability to manage, through unitization, assets for any of the other funds (Judges', Legislators', SIP, Long Term Care, etc.) under CalPERS' purview and therefore this resource should remain a shared one for all of CalPERS, and not a dedicated Inflation-Linked portfolio. The migration over time of Timberland and Infrastructure personnel from the Real Estate and AIM asset classes as Staff grows and specialists evolve also appears to be a reasonable solution to us.

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It should be noted that although the agenda item contains some discussion of the potential changes to incentive compensation, it does not contain the typical incentive compensation worksheets which the General Pension Consultant (Wilshire) is required to review prior to approval by the Performance and Compensation Sub-Committee and the Investment Committee. Given the large number of people affected (CIO; SIOs for Asset Allocation, AIM, Real Estate, and Fixed Income; TIPS portfolio managers; Commodities portfolio manager; and other Real Estate and AIM Staff who will work on the Infrastructure and Timberland assets), Staff will present for approval in December much more detailed information regarding the incentive compensation structures for all Staff involved. Once this has been presented and accepted, we would consider the Investment Committee's requirement satisfied.

We look forward to working with you over the next few months in developing the remaining elements required to launch this new asset class and begin funding new investments.

If you have any additional questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael J. Smith", with a long horizontal flourish extending to the right.